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Statement of

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Chairman Watt, Ranking Member Miller, and members of the Subcommittee, I want to thank you for this opportunity to discuss whether the collection of data by creditors on credit applicants' personal characteristics (such as race, ethnicity, and sex) for non-mortgage loans is appropriate, and if so, how this might best be accomplished.

In my remarks today, I will provide background information on efforts by the Federal Reserve Board to combat credit discrimination, as required by the Equal Credit Opportunity Act (ECOA), and on the collection, reporting, and public disclosure of applicant characteristic data, as required by the Home Mortgage Disclosure Act (HMDA). I will also outline the Federal Reserve's fair lending examination program for non-mortgage products, and discuss the cost-benefit tradeoffs involved in collecting, reporting, and publicly disclosing applicant characteristic data for non-mortgage lending, including small business.

A. Background on Credit Discrimination and Data Collection

ECOA, enacted in 1974, generally prohibits creditors from discriminating against any credit applicant on any prohibited basis (such as race, national origin, religion, age or sex) in a credit transaction. ECOA is implemented by the Board's Regulation B. In fashioning Regulation B, a fundamental question for the Board was whether permitting lenders to note characteristics that, by law, they cannot consider, would advance or impede the goals of ECOA. The statute itself is silent on this issue.

In 1977, the Board adopted a rule generally prohibiting creditors from collecting data on the personal characteristics of loan applicants. At the same time, however, the Board required creditors to collect applicants' race/national origin, sex, marital status, and age for home purchase and refinance loan transactions. The Board adopted this limited data collection requirement based on frequent and serious allegations of unlawful discrimination in the home

mortgage market and the significant impact that access to mortgage credit can have on consumers. Collection of these data was designed to help enforcement agencies better monitor home mortgage lenders' compliance with ECOA. The Board did not, however, require reporting or public disclosure of applicant characteristic data collected in mortgage transactions.

Reporting and public disclosure of the personal characteristics of individual borrowers and applicants for home mortgage loans occurred when the Congress amended HMDA in 1989, and the Board revised Regulation C to implement those amendments. HMDA is a disclosure statute that requires lenders to collect, report, and publicly disclose information about housing-related loans and applications for these loans, including several borrower or applicant personal characteristics.

HMDA has three purposes. One purpose is to provide the public and government officials with data that will help show whether lenders are serving the housing needs of the neighborhoods and communities in which they are located. A second purpose is to help government officials target public investment to promote private investment where it is needed. A third purpose is to provide data that assist in identifying possible discriminatory lending patterns and facilitate the enforcement of anti-discrimination laws, such as ECOA.

HMDA requires mortgage lenders to disclose annually information about each application or loan (such as the loan type and purpose); each applicant or borrower, (ethnicity, race, sex, and income); and each property. Since 2005, pursuant to Board changes to Regulation C, lenders have also been required to report certain price data on higher-priced loans. Based on cost and privacy concerns, however, HMDA data lack several factors that lenders routinely use to make credit decisions and set loan prices, such as information about the borrower's creditworthiness and loan-to-value and debt-to-income ratios. Although HMDA data

alone cannot prove discrimination, the data can facilitate fair lending enforcement by helping regulators identify lenders that warrant further review.

In 1999, the Board proposed to amend Regulation B to allow creditors to collect applicant characteristic data voluntarily. This proposal was very controversial. Consumer groups generally favored lifting the prohibition, but believed that voluntary collection should only be a "first step" toward mandatory data collection. Members of the industry generally opposed lifting the prohibition, fearing that voluntary collection would lead to mandatory collection and impose substantial costs and burdens on the industry. They also believed that data collected on a voluntary basis without standards would be unreliable, of questionable value, not comparable from creditor-to-creditor, and subject to misinterpretation. Some consumer groups also recognized that voluntary data collection may not produce quality data. The Board did not propose, or request comment on, mandatory collection of applicant characteristic data or public disclosure of such data for non-mortgage loans in its 1999 proposal.

In 2003, the Board adopted a final rule that retained the general prohibition on collecting applicant characteristic data for non-mortgage loans. The Board concluded that voluntary data collection would not be effective or desirable because a voluntary collection regime would not produce reliable or useful market-wide data. Under a voluntary data collection regime, the data would be incomplete because some creditors would elect not to collect. In addition, the reliability of the data could not be assured because the data would be collected using different standards, criteria, and methods. Thus, the data would not be comparable from creditor to creditor. At the same time, the Board revised the general prohibition on data collection to permit creditors to collect information about non-mortgage credit applicants' personal characteristics for

the purpose of conducting a self-test in accordance with ECOA's self-test privilege.[1] Some industry commenters indicated that creditors likely would not collect applicant characteristic data voluntarily unless they could take advantage of the self-test privilege.

B. Fair Lending Enforcement for Non-Mortgage Loans

The Board has a rigorous fair lending enforcement program that includes non-mortgage lending. This is consistent with the Board's longstanding commitment to ensuring that every bank it supervises complies fully with the federal fair lending laws (ECOA and the Fair Housing Act). Fair lending is an integral part of every consumer compliance examination. Following the Interagency Fair Lending Examination Procedures, each fair lending examination includes an assessment of the bank's fair lending risk across all types of lending, such as mortgage, consumer, auto, and business lending. Based on this assessment of risk, examiners identify specific business lines on which to focus, and in every examination they evaluate in detail at least one product or class of products.

When examiners find fair lending violations, the Board takes appropriate supervisory action. If there is reason to believe that an institution has engaged in a pattern or practice of discrimination under certain provisions of ECOA, the Board, like the other federal banking agencies, has a statutory obligation to refer the matter to the Department of Justice (DOJ).[2]

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[1] Congress added the self-test privilege to ECOA in 1996 as a way to encourage creditors to assess voluntarily the level or effectiveness of their compliance with ECOA and Regulation B. A self-test is a program, practice, or study designed and used by the creditor specifically to determine compliance with ECOA. A report or result of the self-test is privileged and may not be obtained or used in an examination or investigation, or in any proceeding or lawsuit alleging a violation of ECOA or Regulation B.

[2] After receiving an agency referral, DOJ reviews the matter and decides if further investigation is warranted. A DOJ investigation may result in a public civil enforcement action or settlement. DOJ may decide instead to return the matter to the Board for administrative enforcement. If a matter is returned to the Board for administrative enforcement, the Federal Reserve ensures that the bank corrects the problems and makes amends to the victims.

During the first six months of 2008, the Board referred two institutions to DOJ after concluding that there was reason to believe that the institutions had engaged in a pattern or practice of discrimination. Both referrals involved marital status discrimination in non-mortgage lending. One referral involved illegal spousal guarantees in commercial and agricultural lending. The other referral involved illegal spousal signature practices in automobile lending.

In 2007, the Board referred eight institutions to DOJ. Five of these eight matters involved non-mortgage lending, including auto, commercial, agricultural and consumer lending. One non-mortgage referral involved racial discrimination in the pricing of automobile loans. The institution purchased loans in which auto dealers had charged higher interest rates, through the use of mark-ups, based upon the race of the borrowers. This pricing was permitted by the institution, which received a share of the mark-ups. Four non-mortgage referrals involved marital status discrimination in agricultural, business, and consumer loans.

In 2006, the Board referred four institutions to DOJ. Three of these four referrals involved non-mortgage lending--two non-mortgage referrals involved marital status discrimination in auto loan pricing and one involved age discrimination in consumer lending.[3] The Board referred a total of five matters to DOJ in 2004 and 2005, four of which involved marital status discrimination in auto and commercial lending. As these referrals demonstrate, the Board has a strong fair lending enforcement program for non-mortgage lending.

To test for discrimination, Federal Reserve examiners use statistical techniques, where appropriate, and review information in loan files. When testing for discrimination in mortgage lending, examiners analyze data collected under HMDA to determine the race, ethnicity, and sex of the applicant or borrower. In non-mortgage lending, where lenders do not collect data about

[3] ECOA generally prohibits creditors from considering age when evaluating creditworthiness, except that a creditor may consider the age of an applicant 62 years or older in the applicant's favor.

race, ethnicity or sex, examiners may use proxies, such as names or census tract demographic data, to ascertain this information.

In both mortgage and non-mortgage lending, examiners regularly test for redlining by comparing lending patterns between minority and non-minority neighborhoods. Examiners then determine if a lender is treating neighborhoods differently based on the race or ethnicity of their residents.

C. The Collection of Applicant Characteristic Data for Non-Mortgage Loans

There are four possible approaches to the collection of applicant characteristic data: a general prohibition on data collection; voluntary data collection; mandatory data collection without public disclosure; and mandatory data collection with public disclosure. I will discuss each of these approaches, and then address specific issues related to data collection for small business loans.

1. Four Approaches to Data Collection

A general prohibition on collecting applicant characteristic data is the approach followed in Regulation B for non-mortgage loans. For credit that typically is granted using automated underwriting systems and without face-to-face contact between the creditor and the consumer, such as credit cards, this approach seems clearly appropriate. There do not appear to be widespread fair lending concerns with regard to credit cards that might indicate a need for the collection of applicant characteristic data.

Voluntary collection of applicant characteristic data is the approach considered, but rejected, by the Board in 2003. As discussed previously, voluntary data collection would not be effective or desirable because it would not produce reliable or useful market-wide data. Therefore, voluntary data collection does not appear to be a useful approach.

Mandatory collection of applicant characteristic data without public disclosure is the approach that the Board adopted under Regulation B in 1977 for mortgage loans to obtain information for monitoring purposes. This approach can provide supervisory agencies that regularly examine creditors for fair lending compliance with additional data that can be useful in identifying possible discriminatory practices. However, many creditors, such as non-bank finance companies and auto dealers, are not subject to regular examinations for fair lending compliance. Thus, data collection without public disclosure may not enhance fair lending enforcement against creditors that are not subject to routine oversight.

Moreover, a requirement to collect applicant characteristic data for non-mortgage loans would impose costs on creditors. These costs must be weighed against the benefits of collecting these data. Depending upon the complexity of the products for which data must be collected and the nature and scope of the data that must be collected to identify potential discrimination, these costs could be significant and could outweigh the benefits of requiring collection.

Mandatory collection of borrower and applicant characteristic data with public disclosure is the approach used under HMDA. Public disclosure can provide heightened scrutiny of lender practices by entities other than enforcement agencies. It may be that the availability of HMDA data has led some mortgage lenders to review their loan decisions more carefully to ensure compliance with fair lending laws. The transparency provided by the 1989 amendments to HMDA, which required mandatory data collection, reporting, and public disclosure of borrower, applicant, and loan data, has been viewed by some to have reduced discrimination in mortgage lending more so than the requirement in Regulation B to collect applicant characteristic data for mortgage loans. It would be impossible to validate or refute that argument statistically, however.

Although such an approach would provide greater transparency than mandatory collection alone, it also raises significant policy choices and cost-benefit considerations that Congress should make. A fundamental question is the proper scope of any mandatory collection, reporting, and public disclosure requirement for non-mortgage loans. Congress is in the best position to decide whether such a requirement should apply to all non-mortgage loans, or some subset of those loans.

Another key issue is whether the benefits of mandating data collection and public disclosure for some or all non-mortgage loans outweigh the costs. It is questionable whether any data collection, reporting, and public disclosure requirement can be designed to conclusively show the existence of discrimination. The usefulness of a system that could identify possible discriminatory practices without conclusively proving discrimination, and justification of the costs of implementing such a system, are policy judgments for Congress to make. In summary, we believe Congress is in the best position to make the policy and cost-benefit determinations discussed above, just as Congress did when it amended HMDA in 1989 to require the collection and disclosure of borrower and applicant characteristic data for mortgages.

2. Data Collection Issues Related to Small Business Lending

Small businesses are an integral part of the U.S. economy. Ensuring equal access to small business credit for all qualified business applicants is critical to the welfare of local communities and the economy as a whole.

Small business lending, however, is more complex than mortgage lending and varies across lenders much more than mortgage lending. There are many different types of small business lending, including credit lines, business credit cards, vehicle and equipment loans, mortgages, capital leases, and trade credit. There are also many different types of small business

lenders, including banks, credit card companies, finance companies, and trade creditors. Small businesses in one industry may have very different credit needs than small businesses in other industries. Small business loans may be secured or unsecured, or may be supported by the personal guarantee of the owner or owners of the business.

Many different types of data about business attributes and underwriting standards would have to be collected about small businesses and their owners in order to identify potential discrimination in small business lending. When evaluating small business loan applications, lenders may consider a variety of different factors about the business and its owners. Relevant factors may include: the age or longevity of the business; the track record of the business in terms of sales growth and profitability; the size of the business as measured by employment, sales, and assets; the industry in which the business operates and the risk of lending to businesses in that industry; the experience of the owners of the business; and the personal creditworthiness of the owners of the business. Therefore, it would likely be more difficult to capture the appropriate underwriting-related or pricing-related variables for small business lending than for mortgage lending.

Younger and smaller businesses generally are considered more risky than larger, more established businesses. Younger firms, for example, may have difficulty borrowing from lenders that require prospective borrowers to provide several years of financial statements with their loan applications. Similarly, certain types of businesses, such as restaurants, generally are considered more risky than businesses engaged in other industries.

Given the complexity of small business lending and the various factors evaluated in making loans to small businesses, it would be challenging to design a system for collecting, reporting, and publicly disclosing the personal characteristics of small business owners and other

relevant information that would be useful for identifying possible discriminatory practices in small business lending. In addition, the costs to industry for implementing such a system could be quite significant.

Conclusion

The Board is committed to addressing racial and ethnic gaps in the availability and affordability of credit. The availability of HMDA data has provided transparency in the mortgage market and spurred efforts to address racial and ethnic disparities. A similar requirement to collect, report, and publicly disclose race, ethnicity, and sex data for other types of lending, such as small business and auto lending, could possibly enhance fair lending enforcement. However, such a requirement would be challenging to implement, especially given the complexity of small business lending, and could impose significant costs on lenders. Just as Congress required the collection, reporting, and public disclosure of applicant characteristic data in HMDA for mortgage loans, we believe that a decision about establishing a comparable collection, reporting, and public disclosure requirement for non-mortgage loans is also a decision for Congress to make.